APPLICATION OF

WASHINGTON GAS LIGHT COMPANY **CASE NO. PUE000353**

For approval of a special rate and contract

REPORT OF MICHAEL D. THOMAS, HEARING EXAMINER

November 14, 2000

On July 6, 2000, Washington Gas Light Company ("Washington Gas") filed an Application for Approval of a Special Rate and Contract (the "Application") pursuant to § 56-235.2 of the Code of Virginia. Washington Gas seeks approval of a proposed Service Agreement for Delivery Service (the "Agreement") dated March 28, 2000, between Washington Gas and Johns Manville International, Inc. ("Johns Manville"). The proposed Agreement contains a special rate negotiated by the parties for natural gas delivery and balancing services to Johns Manville's plant located in Shenandoah County, Virginia.

At its Shenandoah County plant, Johns Manville manufactures thermal roof insulation boards used in commercial and industrial roofing applications. This product is known as Fesco® Board. The manufacturing process uses recycled newspaper and other materials that are treated and formed into insulation boards. The plant uses a significant volume of natural gas in the production and post-production process. Johns Manville currently manufactures Fesco® Board at two other plants located in Illinois and Mississippi. Johns Manville operated a fourth plant in Kentucky, but closed that plant in April 2000, due to the excessive cost of production. As a result of this plant closure, the remaining plants have increased production to meet demand for this product. In the past, the Shenandoah County plant operated for ten days and then stopped production for four days to perform required maintenance. Since the beginning of the year, however, the plant has operated 24 hours a day, seven days a week, with scheduled maintenance performed over a 12-hour period every two weeks. As a result of the increased operations at the plant, Johns Manville expects to use approximately 50% more natural gas at the plant than it has in the past.

The Commission issued Washington Gas a certificate (Certificate No. G-150) on January 18, 1980, to install facilities to serve the plant. Washington Gas constructed a 4.5 mile 4-inch pipe from an interstate transmission pipeline owned by Columbia Gas Transmission Corporation ("Columbia Transmission") to the plant. Since its construction, Washington Gas has added additional customers along this pipeline, including approximately 160 residential and commercial customers in the Town of Woodstock, Virginia. For this reason, Washington Gas could not consider selling its pipeline to Johns Manville. Washington Gas will not need to construct any additional facilities to meet Johns Manville's increased demand for natural gas. For the foreseeable future, Washington Gas has adequate capacity to meet the service needs of all of its customers along its pipeline.

Washington Gas currently provides interruptible delivery service to Johns Manville under its Rate Schedule No. 7. The charges under Rate Schedule No. 7 include a monthly System Charge of $100.00 and Commodity Charges of 7.27¢ per therm for the first 75,000 therms delivered during the billing month and 3.82¢ per therm for all therms in excess of 75,000 delivered during the billing month. Johns Manville subscribes to Washington Gas's Comprehensive Balancing Service and pays the tariff charge of 0.66¢ per therm in Comprehensive Balancing Charges under Rate Schedule No. 7. In addition to these charges, Johns Manville must purchase the natural gas and transportation services from interstate pipeline suppliers, and have the gas delivered to Washington Gas's gate station.

Johns Manville conducted an internal economic feasibility study to determine the benefits of installing its own dedicated pipeline from Columbia Transmission's interstate pipeline directly to its plant, and abandoning service through existing Washington Gas facilities. The study indicated that, even at historical natural gas usage levels, the installation of its own dedicated pipeline would produce favorable economic benefits for the company. These benefits were even more favorable when the increased gas usage at the plant was taken into consideration. After this study was completed, Johns Manville retained an engineering firm to substantiate its internal findings. After Johns Manville evaluated the engineering firm's study, it began to acquire the necessary rights-of-way to construct and maintain the pipeline. Johns Manville was engaged in the engineering design process for its pipeline when it reached the Agreement with Washington Gas on the special rate and terms and conditions of service.

SUMMARY OF THE RECORD

Washington Gas's Application was supported by the testimony of three witnesses: George E. Chastka, director of sales and new market development in the business development department of Washington Gas; Kenneth J. Lee, section leader – cost of service in the report preparation process department of Washington Gas; and Leo M. Radkowski, manger, energy supply for Johns Manville International, Inc.

Mr. Chastka's testimony covered some of the background information set forth above. He provided the specifics of the Agreement. The Agreement is a long-term contract for gas delivery service, with the most significant provision being the proposed special rate. Washington Gas has agreed to deliver all volumes of gas delivered to the company's city gate on behalf of Johns Manville, consistent with the Agreement's balancing provisions. The proposed special rate is a declining block rate for gas delivered to Johns Manville each month. The Agreement also has a provision for annual pricing of gas delivered to Johns Manville. There is a provision for annual review of the monthly billings in the aggregate to ensure the Agreement's rates are paid. The Agreement also contains balancing provisions for gas delivered to Washington Gas. If approved, the contract would continue in effect for five years and from year-to-year thereafter until canceled by either party upon 180 days prior written notice. (Ex. GC-2, at 3-4).

Washington Gas and Johns Manville negotiated the terms of the Agreement over the course of several months. Mr. Chastka was the principal negotiator for Washington Gas. He believes the Agreement will allow Washington Gas to earn an acceptable return on its investment in the facilities it constructed to serve Johns Manville's plant. He further believes Washington Gas obtained the most favorable terms, including rates, that it could through the negotiation process. Finally, he believes that, if the Commission does not approve the Agreement, Johns Manville will construct its own dedicated pipeline to Columbia Transmission's interstate pipeline and bypass Washington Gas's system. (Ex. GC-2, at 4-5).

Mr. Lee's testimony covered the effect of the special rate on Washington Gas's revenues, expenses, and the return on rate base for Johns Manville's own customer class. Mr. Lee also described the rate impact of the Agreement on Washington Gas's other customers. He explained how Washington Gas would ensure that other customers would be protected from bearing any increased rates as a result of the Agreement, and how Washington Gas would allocate the resulting benefits. Mr. Lee prepared an exhibit that compares the projected financial results of serving Johns Manville under the Agreement with Washington Gas's historical results from serving Johns Manville. (Ex. KL-4, at 2; Ex. KL-5).

Mr. Lee testified that, if the Commission rejects the Agreement and Johns Manville exercises its bypass option, the revenues in the interruptible class would decrease and the return on rate base for the interruptible class would likewise decrease. Washington Gas's expenses would remain unchanged whether the Agreement is approved or rejected. The company's other ratepayers would bear the cost of supporting $300,000 of net rate base built to serve Johns Manville. If the Agreement is approved, the return on rate base for Johns Manville, as its own customer class, would be in excess of Washington Gas's currently authorized return over the term of the Agreement. Until Washington Gas's next base rate case, the Agreement has no impact on the company's other customers. Any shortfalls between the cost to serve Johns Manville and the revenues received from Johns Manville will be borne by Washington Gas. (Ex. KL-4, at 4-5, 8).

The proposed agreement would change Johns Manville from an interruptible customer to a firm customer. This change does impact the company's Risk Sharing Mechanism ("RSM") established in Case No. PUE880024. As a result, Washington Gas agreed in its rebuttal testimony to lower the target margin used in computing its RSM credit by reducing it by $105,183, the cost of serving Johns Manville. The reduction would be effective with the commencement of service to Johns Manville under the Agreement, thus allowing firm customers to benefit from the retention of service to Johns Manville from the effective date of the Agreement. (Ex. KL-4, at 5; Ex. BB-10, at 2-3).

Based on his usage studies of Johns Manville, Mr. Lee concluded that the Agreement will have a substantial positive return on rate base if Johns Manville reaches its anticipated higher gas usage levels. Mr. Lee recommended that the Commission approve the Agreement. (Ex. KL-4, at 8-9; Ex. KL-5).

Mr. Radkowski's testimony covered the economic and operational viability of installing a dedicated pipeline from Columbia Transmission's interstate pipeline to Johns Manville's plant. He also reviewed the importance of energy and energy costs to Johns Manville's competitive position with manufacturers of competing products and the necessity to procure gas at the most economical price for the plant. (Ex. LR-7, at 2).

Mr. Radkowski described in detail the manufacturing process for its Fesco® Board roofing insulation. The process uses substantial volumes of natural gas for production and post-production. Johns Manville procures natural gas for its manufacturing plants in a number of ways. For its small plants, bundled service is provided directly by the local gas distribution company. For most of its larger plants, including the Shenandoah County plant, Johns Manville's Energy Resources Group coordinates supply, transportation and delivery services, as well as balancing and storage requirements. As a result of increased production at the plant, Mr. Radkowski expects gas usage at the plant to increase by approximately 50%. (Ex. LR-7, at 2-5).

Since the cost of natural gas directly impacts the overall cost of its product, Johns Manville has been evaluating "best value" alternatives for natural gas supplies to its Shenandoah County plant and its other plants. Johns Manville's studies indicated the company would receive economic benefits if it installed its own dedicated pipeline to serve the plant, even at current usage levels. Johns Manville installed a dedicated pipeline to its Fesco® Board plant in Mississippi, and it has completed another study that supports the installation of a dedicated pipeline to serve one of its other plants located in the Midwest. (Ex. LR-7, at 5-6).

Mr. Radkowski provided the company's estimate to construct a dedicated pipeline from the Columbia Transmission interstate pipeline to the plant. Based on its analysis, Johns Manville concluded that it could significantly reduce its natural gas costs if it built the pipeline. It estimated that the pipeline would pay for itself in a relatively short period of time. Mr. Radkowski testified Johns Manville would construct the pipeline if it does not receive a rate from Washington Gas that is within the range of rates Johns Manville would achieve through its own dedicated pipeline. (Ex. LR-7, at 6-7; Ex. LR-7, at Schedules A, B and C).

The Staff presented the testimony of two witnesses: Howard M. Spinner, senior utilities analyst in the Commission's Energy Regulation Division; and Jarilaos Stavrou, principle research analyst in the Commission's Economics and Finance Division.

Mr. Spinner's testimony covered the provisions of the Agreement and its conformance with the Guidelines attached as Appendix A to the Commission's Order in Case No. PUE970695, *Ex Parte, In re: Promulgation of Guidelines for Special Rates, Contracts or Incentives pursuant to Virginia Code § 56-235.2 D.* (20 VAC 5-310-10). Mr. Spinner recommended two amendments to the Agreement in order to mitigate the adverse effect of the special rate on other rate classes. The first involved removing Johns Manville from the RSM, which Washington Gas agreed to do. The second recommendation involved including a provision in the Agreement that Washington Gas could divert gas owned by Johns Manville to serve essential human needs. As an interruptible customer, Washington Gas had the right to interrupt service to Johns Manville to meet residential demand, but a similar provision was not in the Agreement. Both Washington Gas and Johns Manville agreed to amend the contract to include such a provision. (Ex. HS-8, at 1-2, 20-24; Ex. BB-10; Ex. GC-11).

Mr. Spinner found that Johns Manville's threat to bypass Washington Gas's system was economically viable and should be taken seriously. According to the Company's Responses to the Staff's Interrogatories, the project meets Johns Manville's investment criteria and will be constructed if the Commission does not approve the special rate. With the inclusion of the two amendments mentioned above, the Staff does not oppose the Agreement. (Ex. HS-8, at 5, 12-13, 15-16, 24).

Mr. Stavrou's testimony covered whether methodologies used to evaluate the Agreement were reasonable, and whether the Agreement is in the public interest. Mr. Stavrou found the two methodologies used by Washington Gas and Johns Manville to evaluate the economic viability of the project, internal rate of return and net present value, were reasonable. These methodologies indicated that the increased demand for natural gas at the Shenandoah County plant has made the bypass option for Johns Manville economically viable. If Johns Manville bypassed the system, Washington Gas would lose Johns Manville's contribution to fixed costs and those costs would then be allocated to other customers. (Ex. JS-9, at 1-2, 4-6).

DISCUSSION

The question in this case is whether the record supports Commission approval of the Agreement between Washington Gas and Johns Manville for delivery of natural gas and balancing services at a special rate for Johns Manville's Shenandoah County plant. The controlling statute provides, in part, that:

> A. . . . [n]otwithstanding § 56-234, the Commission may approve, either in the context of or apart from a rate proceeding after notice to all affected parties and hearing, special rates, contracts or incentives to individual customers or classes of customers where it finds such measures are in the public interest. Such special charges shall not be limited by the provisions of § 56-235.4. . . .
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> B. . . .
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> C. The Commission shall, before approving special rates, contracts, incentives or other alternative regulatory plans under subsections A and B, ensure that such action (i) protects the public interest, (ii) will not unreasonably prejudice or disadvantage any customer or class of customers, and (iii) will not jeopardize the continuation of reliable . . . service. (Virginia Code § 56-235.2).

This is a case of first impression for the Commission. In the previous cases that came before the Commission, the special rate statute was used to induce a large specialty steel company to locate a new manufacturing plant in Virginia. The special rate in those cases was approved because the economic development and jobs that the company was bringing to Virginia served the public interest. The language of the special rate statute does not limit its use solely to inducing new businesses to locate in Virginia. By its express terms, the Commission should approve a special rate if the business can show that the rate is in the public interest, that the rate will not prejudice or disadvantage other customers, and that service to remaining customers will not be jeopardized. The record in this proceeding supports a finding by the Commission that the special rate contract between Washington Gas and Johns Manville should be approved.

In this case, we have a business that has been operating in Virginia for 20 years. The public interest may not be as readily apparent in this case, but it is still nonetheless significant. As Virginia businesses, such as Johns Manville, seek to compete in the global marketplace, overall product cost is usually the deciding factor between success and failure of that business. In other words, a business must produce a quality product at a lower cost than its chief competitor in order to survive. For Johns Manville, a major component of its overall production cost is the energy used to produce its Fesco® Board roofing insulation. Johns Manville has determined that to become more competitive it must reduce the energy costs used in production. It has initiated an energy review at its manufacturing plants and has closed plants that have high production costs. Although Johns Manville has not indicated that it will close the Shenandoah County plant, the possibility always remains. If the economics justify constructing a new plant where the costs of energy and raw materials are lower, the company may find it beneficial to do so and shift production out of Virginia. The public interest is served by Johns Manville retaining its manufacturing plant in Virginia and continuing to add to the economic prosperity of Shenandoah County.

The public interest is further served by Johns Manville remaining on Washington Gas's system. The Staff determined that Johns Manville's threat to bypass Washington Gas's system and construct its own dedicated pipeline was credible. Johns Manville constructed a dedicated pipeline to serve one of its other Fesco® Board plants, and it was in the engineering design process to construct its own dedicated pipeline for the Shenandoah County plant when it reached the Agreement with Washington Gas. The Agreement continues service to Johns Manville through a pipeline that was constructed specifically to serve its natural gas needs. It avoids the duplication of pipeline facilities. The Agreement provides a positive return on rate base for Washington Gas, and it allows Washington Gas to continue to recover the cost of its pipeline from Johns Manville. In addition, Washington Gas's other customers avoid the burden of recovering the cost of this pipeline in their rates.

The Agreement will not prejudice or disadvantage any other customer or class of customers. As stated above, Washington Gas's other customers are better off with Johns Manville remaining a customer of Washington Gas, than they would be if Johns Manville bypassed Washington Gas's system. The revenues generated from serving Johns Manville will continue to offset Washington Gas's fixed costs, particularly the costs incurred in building the pipeline to serve Johns Manville. If the higher gas usage rates are achieved, Washington Gas could see a substantial positive return on rate base.

The Agreement will not jeopardize reliable service to any other Washington Gas customer. The Agreement, as amended, provides that Washington Gas may divert gas that is owned by Johns Manville to serve essential human needs. If Johns Manville bypassed Washington Gas's system, Washington Gas would no longer have access to this supply of gas to divert in an emergency. With the supply of natural gas expected to be tight this winter, Washington Gas may find it necessary to divert some of Johns Manville's gas to serve the needs of its residential customers in Shenandoah County, some of whom may even be employed at Johns Manville's plant.

FINDINGS AND RECOMMENDATIONS

Considering the foregoing, I find that the Agreement, as amended in Washington Gas's rebuttal testimony, between Washington Gas and Johns Manville meets the requirements of Va. Code § 56-235.2. Accordingly, I ***RECOMMEND*** that the Commission enter an order that:

(1) ***ADOPTS*** the findings contained in this Report;

(2) ***APPROVES*** the Agreement, as amended, between Washington Gas and Johns Manville for delivery of natural gas and balancing services at a special rate to Johns Manville's Shenandoah County plant; and

(3) ***DISMISSES*** this case from the Commission's docket of active cases.

COMMENTS

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and Commission Rule 5:16(e)) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within ten (10) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

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Hearing Examiner